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FEDERAL MARITIME COMMISSION
Office of Service Contracts & Passenger Vessel Operations
Bureau of Tariffs, Certification & Licensing
800 North Capitol Street, Northwest, Room 940
Washington, DC 20573-0001

Re: Comments to Proposed Changes to the Regulations
Passenger Vessel Certificate of Financial Responsibility for Non-performance

Dear Sirs:

These comments are provided as an attorney who represents cruise line clients in their Federal Maritime Commission Certificate applications and coverage arrangements. I have handled FMC matters for start up cruise lines, operators coming to the U.S. for the first time, and smaller foreign based cruise lines who operate one or two ships seasonally from U.S. ports, and I have been doing so for at least fifteen years. These comments are offered from the perspective of my experience in representing those cruise line clients, but they are not made for or on behalf of any particular client, past or present. I make these comments because it is the smaller, one, two or three ship cruise line with unearned passenger revenue of less than $15 million (the coverage cap amount) that have been my typical client, who are today suffering the severe financial consequences from the credit card and surety bond crisis that has arisen since September 2001 and which the proposed regulations intend to address.

Many of my clients have provided their coverage by surety bond, some by escrow agreement, others by the P&I club guaranty, and in several cases I have arranged with the Commission for a change from one form of coverage to another. I have also had clients with business relationships with each of Renaissance, Premier, Commodore, and Regency Cruises as they have failed financially, and I have followed the passenger refund problems that resulted.

The Financial Responsibility Program as Presently Formulated

First I urge the Commission to level the playing field. There is, to my view, no justification whatsoever for the fifteen million dollar coverage cap. With the requirement that operators maintain year around 110% of the maximum unearned passenger revenue they have attained over a two year period, those cruise lines with UPR of less than that sum are *always* providing *more* financial security than their actual UPR, and for most of the year, especially for seasonal operators, they are providing *five, ten times or more* coverage than the amount of their UPR exposure. Larger cruise lines, not necessarily better financed, put up coverage of $15 million, and retain, year around, UPR that is likely to be ten times *greater* than the financial responsibility they have established. I see no justification for this in the statute. And the fifteen million dollar coverage cap imposes a very substantial barrier to entry into the business of offering cruises from U.S. ports, serves the financial interests of the few remaining mega-operators of cruises, and leaves the traveling public at risk for refunds. It has the consequence of removing from the U.S. cruise departure market smaller vessels offering unique itineraries.

The requirement that full coverage be maintained year around, which is a result of the requirement that a Certificate backed by full 100% UPR coverage be in place in order to advertise, discourages operators from offering U.S. cruise departures where the operator provides cruises worldwide with only occasional calls at U.S. ports. This is especially true when the cruises offered are long, transoceanic cruises on luxury vessels, were the UPR for a single cruise is very high. This is one reason why the major cruise ports in the United States are overwhelming offering only large ship, seven day and shorter cruises. The financial responsibility rules discourage the occasional basing of ships in U.S. ports. A simplified method to match *actual* UPR refund exposure, as it appears from time to time, to the coverage requirement needs to be found.

Establishing Financial Responsibility Today Means a Doubling Up of the Counter Security Sums

There is current crisis, and for those operators who are actually providing real, full coverage for their UPR, i.e. those who are not relieved of the program's burden by reason of the $15 million cap, it is a real *crisis*. The surety bond (and P&I club guaranty) method of providing coverage is *not* available for refunding the 85 to 95% of the UPR payments that are made by credit card. The surety companies refuse to extend coverage to credit card processor refunds, *even if they are 100% counter secured* for the bond amount, which is itself *110%* of the maximum UPR! Not only have they refused to respond to the credit card refund claims *after the fact* (the Premier Cruises case), but operators cannot obtain their agreement *before the fact* to extend protection to the cruise line's credit card processor. One surety company, already providing the 110% coverage surety bond with 100% counter security offered a *separate* bond for the credit card processor's refund exposure— but wanted full 100% *additional* counter security for that bond! An obviously impossible situation. The FMC regulations require coverage, which can most easily be met by the use of a surety bond or guaranty, equal to 110% of the *full* UPR. "Full UPR" in this case means UPR derived from *both* cash and credit card payment forms. But the surety bond is actually only effective protection for the cash payment refunds. The credit card merchant banks (processors who deal with the cruise line end of the credit card payment channel) now realize all too well that an FMC bond offers them nothing should there be a refund event.

In a nut shell, the surety companies in today's market, or P&I clubs for guaranties, insist upon one hundred percent counter security for the face amount of the bond. This is 110% of the sum which is the peak UPR over the past two years, and it is required year around. With that counter security, the operator, and the FMC as it now has the financial responsibility program structured, is actually protecting for refunds of not more than *fifteen percent* of the UPR collected, i.e. the surety company bond only protects refunds for payments made in cash.

The credit card processors, having been burned in the cruise line failures– not all of which were even covered by the FMC program, and most of which were only partially covered when they were Certificate holders (the unjustified $15 million cap in the coverage requirement), now want one hundred percent counter security for refund claims that will come to them via credit card charge-backs. This is 85% or more of the total UPR sum as it stands at any particular time (not related to a historic level).

Because an operator must have an FMC Certificate, it has to put with the surety company 110% of the historic highest UPR sum, which often means *two or three hundred percent* of the actual UPR for most of the year. *At the same time*, in order to collect revenues by means of the primary payment method, credit cards, the operator puts up, or has held back, 100% of the current actual UPR. If the operator has a seasonal peak in UPR, at the time of that peak it will have 110% of the UPR as counter security with the surety company, and another 85% of UPR with the credit card processor, for a total counter security for passenger refunds that is *twice* the actual exposure. This result is unnecessary to meet the refund protection objectives of the FMC program, and drives financially sound small operators away from U.S. ports for no good reason.

After the decision in the Premier Cruises case, and the Commission's proposal of new regulations, the only practicable way a small or seasonal operator can meet the coverage requirements is via an escrow agreement. The problem here is the ten percent sum, that amount equal to ten percent of the highest UPR experienced historically within two years, or the projected maximum UPR for start up cruise lines. The present arrangements for escrows require the sum to be paid into the escrow *in cash* before the first dollar of revenue is collected, and to be maintained there year around regardless of the actual amount of UPR held in the account.

Possible Changes to Fix the Problems of the Program

The proposed changes in the regulations seek to remove from UPR the credit card payment sums. The argument seems to be that other legislation working through the credit card processing arrangements provides the equivalent protection to the traveling public. To my sense of things this is an effort to dodge the consequences that will be imposed on the mega-cruise operators by the removal of the $15 million cap on coverage by making it the responsibility of someone else, and of another statute to deal with those passengers paying by credit card. The refund of credit card payment UPR must remain controlled by the Federal Maritime Commission and subject to the programs established pursuant to the relevant statutes assigned to the Commission for administration.

The coverage for credit card payment refunds must simplified and made uniform. The credit card processors for smaller cruise operators are insisting upon upwards to 100% counter security for their charge-back refund exposure. *That counter security* that must be given by cruise operators to function in today's market place, needs to be made available to the non-performance program's refund process, and must be made the basis of an operator's demonstration of financial responsibility, *and must be actively part of the program.* To do otherwise abrogates the Commission's responsibilities under the law in favor of the apparent assumption of earlier Commission actions, "The mega-cruise operators are too big to fail."

Problems with certain elements of the present program need to be addressed to make the cruise operator's compliance reasonable, make the requirements run in proportion to the UPR refund exposure of the operator, and to take into account the ups and downs in UPR over seasonal operations. The following changes are suggested.

1. Credit card processor hold backs and escrow arrangements in respect to payments of UPR should be brought under the purview of the Commission, regulated and made available to satisfy the obligation to demonstrate financial responsibility to make refunds by simple, direct arrangements (escrow agreements) defined in the regulations. The credit card processors for the smaller cruise operators are requiring this now, the financial resources are being gathered by the credit card processors to protect themselves from the charge-back refund claims of the card issuers and their card holders, and the Commission should adopt regulations that make it possible for cruise operators to offer evidence of these arrangements to satisfy their financial responsibility obligations under the program. The Commission will know that the operators, large and small, have made the financial resources available to escrow agents or other responsible parties to assure the refund in full of the whole of their UPR.

2. Provisions should be made to allow for the use of multiple methods of providing coverage. This would mean that a surety bond could be provided for the cash collections and credit card processor escrow arrangements could provide separately for each source of credit card payments (Visa and Mastercard, AmEx, Diners Club, etc.). Each portion of the coverage thus provided would relate only to the UPR collected via that channel, plus ten percent of the current UPR, assuming that aspect is retained.

3. The surety bond form should be amended so that if the operator elects, the language would require the surety company to respond and reimburse refunds made by credit card processors, either specific ones that might be named in the surety bond, or generally, as the operator may negotiate with the surety company. The payments made by surety companies under such bonds to credit card processors for refunds made via the charge-

back arrangements would serve to reduce the surety company's exposure on the bond, something that they claim is not presently the case, and hence why they refuse to extend the FMC surety bond to cover credit card processor refunds claims. This would allow operators to establish a counter security arrangement, by escrow or combination of escrow and financial instruments with the surety company instead of multiple escrows with each credit card processor plus arrangements for the cash collections.

4. As mentioned above, the "ten percent" sum should float and be related to the UPR as it stands from time to time, not determined against the seasonal or historic maximum UPR. This will facilitate the separation of coverage arrangements to meet the particular circumstances of the operators. To open an escrow account before any monies have been collected should have some basic administration costs sum requirements, say $10,000. Thereafter the periodic calculation of the required escrow account balance should be "UPR plus ten percent." That is, current UPR plus that sum which is ten percent *of current UPR*.

5. Financial instruments including letters of credit from suitably qualified institutions should be allowed as assets held on escrow accounts. At present operators have the choice of using letters of credit and other financial instruments as counter security for surety companies issuing bonds, or putting actual cash for UPR and the ten percent sum (10% of maximum UPR as presently approved) into escrow arrangements. The surety companies charge in excess of 2% per year to issue the bonds even when fully counter secured. This is an unnecessary cost imposed on the cruise operators simply to convert letters of credit into an acceptable form of coverage. There should be general arrangements by which the sound financial instruments that are acceptable today to the surety companies can be available to *directly* satisfy the FMC coverage requirements. If financial responsibility is to be provided for the full UPR amount without the $15 million cap on coverage, this will be a very large savings to the industry.

6. The point at which UPR becomes "earned" needs to be the point where the vessel sails on the cruise. There are various forms of recovery for damages that passengers might claim from ship owners in respect to cruises commenced but not finished. These include P&I indemnified recoveries of claims of shipowner liability, and direct claims against the vessels themselves that often will come ahead of mortgage lender's claims. The program the FMC administers for "non-performance" is aimed at the cruise operator who does not embark the passengers and fails to make refunds. For the mega-cruise operators this will not be a significant issue. They operate seven day cruises with departures every week year around. But for the small operator who embarks passengers at Los Angeles for a forty five day cruise, the actual "refund" exposure goes down every day of the cruise that is performed. To require, as the present escrow terms do, that UPR is not removed from the total until the cruise is completed, to the last day, is unnecessary to meet the program's

objectives, and very burdensome to operators who operate long cruises with only occasional departures from U.S. ports.

Please consider these comments in the course of the Commission's review of this program and the changes you may make to adjust to the financial and credit card payment circumstances of the industry today.

Very truly yours,

Glenn G. Kolk